The Reserve Bank of Australia: The Big Brother of the nation?

By Patrick Chen

Have you ever wondered why the Australian economy runs so smoothly, or where your $100 bills come from? Well, the answer lies within the Reserve Bank of Australia, otherwise commonly referred to as the RBA. Since 1959, the RBA has acted as Australia's central bank and banknote issuing authority. Its roles include maintaining a stable currency and full employment, economic prosperity and welfare of Australians as well as ensuring optimal functioning of its wholly owned subsidiary, Note Printing Australia (which is Australia's primary banknote producer). The RBA achieves this through implementations of monetary policies. Monetary policy involves the determining of the cash rate (the interest rate that a central bank, such as the RBA, charges on commercial banks, such as Westpac and ANZ, on loans) which then influences other interest rates. Changes in interest rates will affect economic activity and the behaviour of consumers which then causes changes to the rate of inflation. Therefore, monetary policies are used to control inflation and performed through setting the cash rate and other interest rates.

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For example, first homebuyers may be more willing to seek out a loan when interest rates are low (so they won't have to pay as much when paying back the loan) and therefore by setting low interest rates, the RBA actually influences the behaviour of consumers and encourages people to spend more. In other words, the RBA is able to manipulate the consumption behaviours of Australians through changes in the interest rate. Currently, the RBA has cut the interest rate to a historic low of 0.25% in hopes of stimulating the economy in these unprecedented times which encourages people to borrow money and spend it, thus increasing economic activity.

It is important to understand the RBA and its role and function in the economy as they may modify policies and goals which may impact your future finances. For example, the RBA aims to keep annual inflation at 2-3% on average while aiming for a Cash Rate Target of 0.25% and a 3-year Australian Government Bond Yield Target of 0.25%. If the RBA decides to change this, almost every Australian will be impacted in a certain way. It is also useful to know when the RBA makes changes to the interest rate. As many of us enjoy our shopping, you may be able to take advantage of lower interest rates to buy a product that you have dreamt of having for a while. Even for you first homebuyers: a lower interest rate would potentially mean not having to pay as much back later down the track!

Meme Explanation: A recession is defined as two successive quarters of negative economic growth and typically occurs when economic activity declines significantly. This situation causes the RBA to lower the cash rate and consequently, other interest rates such as home loan and mortgage interest rates, which allows millennials (typical first or second home buyers) to better access home loans. Therefore, the man above is visibly prepared and ready to take out a home loan.

You may be wondering how the RBA determines the setting of monetary policy within Australia. Well, it depends on various factors going on in the economy such as the strength of the economy and situations that are occurring in the world, such as geopolitical tension or pandemics. The determining of the cash rate is prioritised as it has the ability to influence multiple other interest rates. As discussed previously, the RBA will set its interest rates to achieve its primary objectives: to stabilise the Australian currency, to maintain full employment and to ensure the economic prosperity and welfare of Australians. In times such as these where economic stimulus is required and unemployment is high, the RBA will intentionally lower interest rates. This allows Australians to have more money to spend on goods and services which in turn, help stimulate demand and therefore increase economic activity. On the other hand, if the economy is very strong, the RBA will increase interest rates to slow the economy and control prices and inflation to achieve the objectives.

But who is responsible for the decision making of the RBA? Put simply, the answer is the Reserve Bank Board. This board consists of 9 members: three ex officio members consisting of Philip Lowe (the Governor of the Reserve Bank), Guy Debelle (the Deputy Governor of the Reserve Bank) and Steven Kennedy (the Secretary to the Treasury) as well as 6 non-executive members appointed by the Treasurer. The members meet eleven times each year, on the first Tuesday of each month except for January. Prior to each meeting, the Bank's staff prepare and organise detailed accounts of developments in the Australian and international economies as well as a recommendation for the policy decision. Some senior staff may also attend the meetings and give presentations. Monetary policy decisions are then announced publicly shortly after the meeting's conclusion.

Some dramatization included.

The take-away from this article:

So, what should you take away from this article? The RBA is an influential powerhouse that holds the future performance of the Australian economy in its hands and has the ability to manipulate the behaviours of consumers. This is primarily done through the setting of monetary policy which is decided by the Reserve Bank Board depending on the strength of the Australian and international economies. Understanding the role of the RBA and staying updated on its announcements may allow you to take advantage of the RBA's policy setting. For example, when interest rates are low, spending is encouraged allowing you to organise that home loan to contribute to the purchase of your first house or to finally treat yourself to a shopping splurge. On the other hand, being able to understand that when interest rates are high means that you should spend your money more wisely may be beneficial. Having a full understanding of the RBA would certainly increase your awareness and knowledge about finances and the economy and help you achieve a better quality of life.